U.S. Senate
Republican Policy
Committee

Legislative Notice

Jon Kyl, Chairman

No. 1 February 4, 2005

# S. 5 — The Class Action Fairness Act

Calendar No. 1

*Reported favorably by the Judiciary Committee on February 3, 2005 and placed on the Senate Legislative Calendar under General Orders.*

## Noteworthy

- By unanimous consent, the Senate will proceed to the consideration of S. 5 on February 7 at 3:00 p.m. Only related amendments will be in order. There is no time agreement for debate.
- S. 5 was reported favorably by the Judiciary Committee on February 3, with no amendments. The bill passed, 13-5, with support from all Republican Senators as well as Senators Feinstein, Kohl, and Schumer.
- In May 2004, the Senate attempted to proceed to an identical bill (S. 2062), but Democrats objected and the Majority Leader filed cloture on the motion to proceed. That cloture motion failed when Democrats insisted on being able to file non-germane amendments.
- S. 5 is the result of bipartisan compromise that arose after an earlier failed cloture vote. In October 2003, the Senate failed to reach cloture on a motion to proceed to an earlier version of class action reform, S. 1751. When cloture failed (59-39), the bill's sponsors negotiated changes that, according to their statements in contemporaneous press reports, were satisfactory to then-opponent Senators Dodd, Landrieu, and Schumer. All the changes negotiated then are embodied in S. 5.
- Only one amendment received a vote during the Committee markup — an amendment to increase judges' salaries — but it was rejected by all 13 of the bill's supporters.
- Additional amendments are expected on the Senate floor.

# Background

Class action lawsuits allow plaintiffs whose injuries might not be worth enough to justify bringing individual suits to combine their claims into one lawsuit against a common defendant. In recent years, however, a relatively small number of class action plaintiffs' attorneys have abused the class action procedures. The effects have been dramatic: a distortion of our federalist system by the actions of a few rogue state courts; excessive attorney fee awards at the expense of injured plaintiffs; unprecedented costs to the national economy; and an overall decline in public respect for our nation's judicial system.

***The Loophole in Federal Court Jurisdiction Rules for Multi-State Class Actions***. The U.S. Constitution provides for federal jurisdiction over all lawsuits between citizens of different states, i.e., those cases where the parties are of "diverse" citizenship. Today, the most obviously "national" types of litigation — multi-million-dollar class action lawsuits involving national companies engaging in interstate commerce with citizens of many states — are often stuck in state court. This is because *Congress* has narrowly construed constitutional diversity to require "complete diversity" — requiring *all* plaintiffs to be diverse from *all* defendants. Consequently, national class actions with plaintiffs from all 50 states and defendants from multiple states are rarely eligible for federal court. The current rules allow lawyers to game the system and direct their claims to certain state courts. The result of this "forum shopping" is that a few state courts effectively regulate national industries and professions beyond state borders.

The Constitution provides for federal jurisdiction over cases between citizens of different states precisely so that parties never have to deal with questions of local bias. The Senate need not pass judgment on the quality of state court judges — most of whom are undoubtedly of high integrity and competence — to recognize that national, multi-state class actions should not be barred from the federal courts. However, Congress must change the diversity rules to ensure national class actions are heard in their proper forum — federal court.

***The Growing Abuse of Coercive Interstate Class Actions.*** A lawyer-driven class action industry devoted to finding opportunities to extract financial payments from American business has developed in the past few decades. A focused group of attorneys "shop" throughout the nation for the friendliest courts to hear possible cases. They drag interstate businesses into carefully chosen state courts where judges hastily certify cases as class actions without regard to Due Process concerns and where juries are known to render extravagant awards. Many of these lawsuits implicate citizens of many states and involve interstate commerce — precisely the kinds of lawsuits better suited to the federal courts. One study estimates that virtually every sector of the U.S. economy — including long-distance carriers, gasoline purchasers, insurance companies, computer manufacturers, and pharmaceutical developers — is on trial in *only three counties* (Madison County, Ill.; Palm Beach County, Fla.; and Jefferson County, Tex.).

***Current Class Action Abuses Continue to Harm Plaintiffs.*** Injured plaintiffs are suffering due to weak state court oversight of class action lawsuits. As a result of lax

supervision, the legal system returns less than 50 cents on the dollar to the people it is designed to help, and only 22 cents to compensate for actual economic loss.[1]

Many settlements consist of extravagant payments to plaintiffs' attorneys and nothing of real value to the injured plaintiffs. For example, in a case against Blockbuster, Inc., customers who alleged they were charged excessive late fees for video rentals were to receive $1 coupons while their attorneys received over $9 million.[2] In an Illinois case about cellular phone charges, settling class members received coupons to buy future products, while their attorneys received more that $1 million in fees.[3] In a similar "coupon" case settlement in California, class members received a $13 rebate towards the purchase of new computer monitors, while their attorneys received $6 million.[4] These coupon settlements represent a boon to plaintiffs attorneys (who receive the bulk of the benefit) and defendant companies (because coupons are rarely redeemed).

Injured plaintiffs also suffer when they receive complicated settlement notices that fail to explain clearly their right to challenge the settlement or to enjoy its full benefits. Also troubling are settlements crafted to provide very large payments to the original "named" plaintiff in order to persuade that plaintiff to agree to a settlement that will give fellow class members far less, if any, compensation.

***The Costs of Runaway Litigation to the National Economy.*** Over the past decade, class action lawsuits have grown by over 1,000 percent nationwide.[5] These increased claims inevitably produce hasty, unjust settlements. This is because class actions aggregate many potential claims into one lawsuit, and in many cases an unfair or unconstitutional class certification ruling cannot be appealed until after an expensive trial on the merits. Defendants face the risk of a single judgment in the tens of millions or even billions of dollars, simply because a state court judge has rushed to certify a class without proper review. The risk of a single, bankrupting award often forces defendants to settle the case with sizable payments even when the defendant has meritorious defenses. As one federal court explained, "The risk of facing an all-or-nothing verdict presents too high a risk, even when the probability of an adverse judgment is low. These settlements have been referred to as judicial blackmail."[6] This "judicial blackmail" imposes increased costs on the economy, causing higher prices, lower wages, and the enrichment of those attorneys who brought the weak claims in the first place. When litigation costs become too unpredictable, the effect will be to dissuade investment, discourage

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[1] Tillinghast-Towers Perrin, U.S. Court Costs: 2002 Update, Trends and Findings on the Costs of the U.S. Tort System, at 1, available at http://www.tillinghast.com/tillinghast/publications/reports/2002_Tort_Costs_Update/Tort_Costs_2002_Update_rev.pdf. Tillinghast is an international actuarial and management consulting company that has been examining the U.S. legal system's costs in published studies since 1985.

[2] "Blockbuster customers to be reimbursed for late fees," Associated Press, 11 Jan. 2002, discussing Scott v. Blockbuster, Inc., No. D162-535 (Jefferson County, Texas, 2001).

[3] Michelle Singletary, "This 'Settlement' Doesn't Ring True," Washington Post 5 Sept. 1999, at H-01.

[4] Michelle Singletary, "'Coupon Settlements' Fall Short," Washington Post 12 Sept. 1999, at H-01.

[5] Class Action Watch, Vol I, No. 2 (Spring 1999), available at http://www.fed-soc.org/Publications/classactionwatch/classaction1-2.pdf (finding increase of 1,315 percent over previous decade); Tillinghast-Towers Perrin at 1.

[6] Castano v. American Tobacco Co., 84 F.3d 734, 746 (5th Cir. 1996); see also Coopers & Lybrand v. Livesay, 437 U.S. 463, 476 (1978) ("Certification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense"); In the Matter of Rhone-Poulenc Rorer, Inc., 51 F.3d 1293 (7th Cir. 1995) (noting the "intense pressure to settle" rather than "roll[ing] the[] dice" by taking the case to a jury).

entrepreneurship, increase the costs of risk planning, and threaten the core activities essential to our economy.

*For additional background information, see the Senate Republican Policy Committee's background paper on the subject, "The Need for Class Action Reform," April 29, 2003, available at http://rpc.senate.gov/_files/JUDICIARYsd042903.PDF.*

## Bill Provisions

**Section 1**

Establishes the "Class Action Fairness Act of 2005" as the short title.

**Section 2**

Sets forth findings, including: (1) class actions are a valuable part of the legal system; (2) recent abuses of the class action system have undermined justice and adversely affected interstate commerce; (3) class members often receive little or no benefits from class actions; and (4) abuses of the class action system undermine justice by keeping cases of national importance out of federal court and enable some state courts to bind residents of other states. The purpose of this bill is to assure fair and prompt recoveries for class members with legitimate claims, to ensure federal court consideration of interstate cases of national importance, and to benefit society by encouraging innovation and lowering prices.

**Section 3**

Sets forth a "Consumer Class Action Bill of Rights" to help ensure that class actions do not hurt their intended beneficiaries — class members. That bill of rights includes the following provisions:

- Federal courts must hold a hearing and find that the settlement is fair before approving any class action settlement in which class members receive coupons as compensation.
- Attorneys' fees for coupon settlements must be based either on (a) the value of coupons actually redeemed by class members or (b) the hours actually billed in prosecuting the class action (with no prohibition on "lodestar multipliers"). (Lodestar multipliers allow hourly fee awards to be increased due to the risk taken by plaintiffs' counsel in taking the case, special expertise required, and other factors.)
- Adds a provision permitting a federal court to require, at its discretion, that the settlement provide for distribution of a portion of the value of unclaimed coupons to a charitable organization or government entity; however, such a distribution may not be used as a basis for a fee award.
- Federal courts may not approve any coupon settlement that provides greater payments to certain class members based solely on where they reside.

- Defendants must notify appropriate federal and state authorities of all proposed settlements to ensure an additional layer of independent oversight.

**Section 4**

Changes the federal jurisdiction rules for class actions.

New Standard for Federal Jurisdiction for Class Actions [subsection 4(a)(2)]

Under this section, federal courts will have original jurisdiction over class action lawsuits in which the matter in controversy:

- Exceeds the sum or value of $5 million;
- Includes 100 or more putative class members; **and**
- Either (a) ***any*** member of the class of plaintiffs is a citizen of a different State from ***any*** defendant; (b) ***any*** member of a class of plaintiffs is a foreign State or a citizen or subject of a foreign State and ***any*** defendant is a citizen of a State, **or** (c) ***any*** member of a class of plaintiffs is a citizen of a State and ***any*** defendant is a foreign State or a citizen or subject of a foreign State.

Exceptions for Suits Against Home-State Defendants [subsection 4(a)(3):

S. 5 contains special rules for suits against defendants in the defendants' home states.

- If at least two-thirds of putative class members are citizens of the defendant's home State, then S. 5 *does not* extend federal jurisdiction to the suit.
- If fewer than two-thirds but greater than one-third of putative class members are citizens of the defendant's home State, then the federal court has the *discretion* to accept or refuse jurisdiction, pursuant to five statutory factors aimed at determining the overall need for federal jurisdiction.
- If fewer than one-third of putative class members are citizens of the defendant's home State, then federal jurisdiction *is proper* because the case is predominantly interstate and may involve the laws of multiple States.

Local Controversy Exception [subsection 4(a)(4)]:

Adds an additional exception allowing cases to remain in state court if:

- More than two-thirds of class members are citizens of forum state;
- There is at least one in-state defendant from whom "significant relief" is sought by members of the class and whose conduct forms a "significant basis" of plaintiffs' claims;

- The principal injuries resulting from the alleged conduct, or related conduct, of each defendant were incurred in the state where the action was originally filed; **and**
- No other class action asserting the same or similar factual allegations against any of the defendants on behalf of the same or other persons has been filed during the preceding three years.

"Mass Action" Exception [subsection 4(a)(11)]:

In some states, there are no class actions — only "mass actions" in which many plaintiffs join and attempt to try their case together. Section 4 of S. 5 treats "mass actions" as follows:

- A "mass action shall be deemed to be a class action" where "monetary relief claims of 100 or more persons are proposed to be tried jointly in any respect on the ground that the claims involve common questions of law or fact."
- Only those plaintiffs who individually meet the jurisdictional requirements for federal court ($75,000 in controversy) would be eligible to be heard in federal court; those with smaller recoveries would remain in state court.
- S. 5 does not apply, and federal jurisdiction is therefore not extended, to mass actions where "all of the claims in the action arise from a single, sudden accident that occurred in the State in which the action was filed, and that allegedly resulted in injuries in that State or in [contiguous] States."
- S. 5 does not apply, and federal jurisdiction is therefore not extended, to mass actions in which the claims are joined by motion of a defendant or when brought on behalf of the general public pursuant to a state statute authorizing that case.
- S. 5 does not permit any transfer of mass actions under the multidistrict litigation rules without a request by a majority of plaintiffs.

Additional Exceptions [subsections 4(a)(5); 4(a)(9)]:

Additional exceptions to federal jurisdiction include:

- Federal jurisdiction will not extend to class actions in which the primary defendants are States, state officials, or other governmental entities against whom the district court may be foreclosed from ordering relief.
- Federal jurisdiction will not extend to class actions in which the number of plaintiffs is fewer than 100.

- Federal jurisdiction will not extend to securities-related class actions or state-law-based class actions regarding the internal affairs of a business enterprise.

Class Composition Rules [subsection 4(a)(7]:

Citizenship of proposed class members is to be determined on the date that plaintiffs filed the original complaint, or if there is no federal jurisdiction over the first complaint, when plaintiffs serve an amended complaint or other paper indicating the existence of federal jurisdiction.

## Section 5

Establishes the procedures for removal of interstate class actions from state courts to federal courts (for those cases under section 4 above where original federal jurisdiction is appropriate).

Makes removal permissible by any defendant without regard to whether the defendant is a citizen of the state in which the action is brought.

Provides discretionary appellate review of remand orders — federal court orders sending previously-removed cases back to state courts — with tight time limits to ensure that appellate courts act quickly.

Excludes securities lawsuits and state-law-based class actions regarding the internal affairs of a business enterprise from this provision.

## Section 6

Directs the Judicial Conference of the United States to prepare a report with recommendations on the best practices that courts can use to ensure fairness in class action settlements.

## Section 7

Accelerates acceptance of revisions to Federal Rule of Civil Procedure 23, as previously recommended by United States Supreme Court.

## Section 8

Clarifies that nothing in the bill restricts the authority of the Judicial Conference and Supreme Court to implement new rules relating to class actions.

## Section 9

Effective Date. This legislation applies to any civil action filed *after* the date of enactment; it does not apply to suits already filed.

## Administration Position

The Administration has not yet issued a Statement of Administration Policy for S. 5. However, the Administration issued a SAP in support of S. 2062 in the 108th Congress.

## Other Views

Some Republican Senators *who nonetheless support S. 5* have argued that it does not do enough to combat abuses of the court system. They have argued that the bill should include provisions to require plaintiffs to affirmatively choose to participate in a lawsuit, instead of being dragged into a lawsuit without their prior consent; that it should better protect against unwise class certifications by mandating automatic appeals and providing stays of discovery during those appeals; that it should protect against fraud on the public by requiring publication of class action settlements; and that it should provide some regulation of contingency fees so that there is some relationship between the work performed, the risk incurred, and the fees paid.

Bill opponents' views are discussed at greater length below. Senators Leahy, Kennedy, Biden, Feingold, Schumer, Durbin, and Edwards filed minority views in relation to an earlier version of the Class Action Fairness Act (S. 274 in the 108th Congress) when it passed through the Judiciary Committee. Those views are available at pp. 73-89 of S. Rept. No. 108-123. Opponents' views are summarized as follows, followed by the responses offered by the Judiciary Committee and other S. 5 advocates.

- Opponents have argued that the class action bill deprives state courts of the power to adjudicate cases involving their own laws. They argue that the bill therefore infringes upon States' sovereignty.

  *The Committee has responded that there is no evidence for this assertion, and that it is the present system that infringes upon state sovereignty rights by promoting a "false federalism" whereby some state courts are able to impose their decisions on citizens of other States regardless of their own laws. (See also Committee Report response at pp. 51-54; 59-60.) In addition, it is important to recognize that the federal courts adjudicate questions of state law <u>all the time</u>. Article III of the Constitution itself anticipates many state law cases being brought in federal courts.*

- Opponents argue that the class action reform bill will cause our federal courts to become overburdened.

  *The Committee has responded that state courts have experienced a much more dramatic increase in class action filings and have not proven to be any more efficient in processing complex cases. The Committee further responds that federal courts have greater resources to handle most complex, interstate class action litigation, and are insulated from the local prejudice problems so prevalent under current rules.*

- Opponents have proposed creating special carve-outs for civil rights cases, state consumer protection cases, state environmental protection cases, gun liability cases, and tobacco cases.

  *The Committee has responded that proponents of such carve-outs have never established that state courts would provide more fair or expeditious treatment for these claims. (Committee Report response at pp. 55-57.) It is also worth noting that advocates of strong civil rights and environmental laws have long argued that federal courts are superior forums for the adjudication of disputes, both due to the elimination of local prejudices and the potential "capture" of state courts by local interests, as well as due to the generally (but not exclusively) higher quality of federal court judges.*

- Opponents argue that federal cases that do not satisfy the requirements of the Federal Rules of Civil Procedure must be dismissed, but that if re-filed in state courts, they would just be removed to federal court and dismissed again. They call this a "merry-go-round" that deprives injured parties of access to the courts.

  *The Committee has responded that this criticism misunderstands the purpose of strict rules governing class action certification. Those rules exist to ensure that classes are certified only for those cases that can be managed on a class-wide basis, i.e., that only those cases where common issues of law and fact predominate over individual issues. If the lawsuits cannot be managed as class actions as a practical matter (usually due to overwhelming numbers of individual factual or legal questions), then they should be refiled as individual lawsuits. This bill does not prevent any case from being refiled on an individual basis in state court should the federal court determine that the requirements of the Federal Rules of Civil Procedure are not met. (Committee Report response at pp. 64-65.)*

- Opponents argue that the bill is designed simply to prevent citizens from getting their day in court.

  *In fact, any claim that can be managed efficiently and fairly as a class action, consistent with the Constitution's Due Process requirements and the rules approved by the Supreme Court and Congress, will be able to proceed expeditiously in federal courts. Federal court judges regularly hear and manage class action lawsuits, and their courthouse doors will remain open to appropriate cases. Moreover, the consumer protection provisions of S. 5 will give plaintiffs more protections than are currently available in state courts.*

## Possible Amendments

It is the Majority Leader's hope that S. 5 will receive bipartisan support without any amendments to the current text. And only "related amendments" are in order under the unanimous consent agreement.

During the Judiciary Committee mark up on February 3, 2005, only one amendment received a vote. Senator Patrick Leahy offered an amendment to increase judicial pay by 16 percent. Although several supporters of S. 5 support an increase in judicial pay, they argued against the amendment in Committee because this bill was an inappropriate vehicle.

However, additional amendments are expected on the floor. Potential related amendments could include: changes to the jurisdictional rules at the core of the bill; changes to the internal court procedures governing review of remand orders; changes to how "mass actions" are handled in the bill; and creation of specific "carve-outs" to allow some kinds of class actions to remain in state court despite their substantially interstate character.

*The RPC will issue Amendment Summaries to Republican offices when they become available.*